

MEMORANDUM

TO: Mr. Stuart Fuller
PHILIP MORRIS, U.S.A.
120 Park Avenue
New York, NY 10017

FROM: Ms. Kathy Rejman
Mr. Chris Lockett
Management Science Associates, Inc.

RE: Basic Price Position Versus Lowest

DATE: November 5, 1993

OVERVIEW

Management Science Associates examined the degree to which Basic is competitively priced in the market and the dynamics behind its price positioning. It was found that a fair degree of variability exists across markets and that the key factor driving this variability is the lowest brand price and not Basic price.

BACKGROUND

Preliminary findings from a recent price elasticity study indicated that Basic could sustain competitive standing if priced within ten cents per pack of the minimum brand in the store. Therefore, it is believed that tactical price support on Basic should emphasize reaching this target gap. In addition, PM recognizes that strategic promotion allocation is necessary so as to avoid triggering a price war.

IMPLICATIONS

Allocation of promotion dollars should vary significantly by market given the variation in Basic's price position alone. An even more efficient market level allocation could be determined based on current price position, gap target, potential volume lift and other factors which address brand management's goals. For instance, should promotion support emphasis be in C-stores versus Supermarkets? In Urban versus rural markets?

FINDINGS

MSA used August Field Sales Price Audit data for approximately 3300 stores to measure the market variability in Basic's price position versus Lowest. For

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this analysis MSA derived two measures: % Stores Non-Competitive and Average gap versus Lowest in Non-Competitive stores. Non-competitive stores are defined as stores in which Basic is priced more than ten cents above minimum. (see attachments 1-4)

On average across the 76 markets, Basic carton price is not competitive in 38% of stores and the average gap in these stores is \$2.20. The variance around these measures is summarized below for packs, as well as, cartons.

	Average	StDev	Max	Min
% Stores Non-Competitive				
Carton	38%	13%	82%	12%
Pack	37%	11%	68%	11%
Gap in Non-Competitive Stores				
Carton	\$2.20	\$0.33	\$3.01	\$1.60
Pack	\$0.27	\$0.04	\$0.40	\$0.21

MSA indexed Basic and Lowest price in each store to the market average and then compared these indices for competitive and non-competitive stores. Using discriminant analysis MSA found that whether Basic has a competitive or non-competitive price is decided by the lowest brand's price and not by Basic's price. (see attachments 5 and 6)

MSA examined the data further to determine which competitive brands would be undercut if Basic's price was reduced to ten cents from lowest in store nationally. PM is interested in ensuring that no one competitor feels threatened by Basic's price repositioning. MSA looked at the data several ways from the competitor's view point. Results are summarized below.

- If competitors view their brand's total distribution then no one brand is undercut more than 20% of the time according to the August Field Sales audit. At the maximum, Basic will undercut Best Value in 19.6% of the stores selling Best Value. (Attachment 7)
- If competitors track stores which sell their brand and Basic then Best Value is undercut the most often in 81% of these stores. (Attachment 8)
- Finally, if competitors examine the stores where Basic reduces price then Doral and RJR B&W are undercut most often in approximately 75% and 50% of these stores, respectively. Note that Cambridge itself is undercut in nearly 80% of these stores. (Attachment 9)

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RECOMMENDED NEXT STEPS

Given a list of management's goals, optimal market level allocation of Basic's promotion dollars could be determined. Assuming that multiple factors need to be considered, allocation could be determined using an algorithm which handles the trade-offs necessary for an acceptable solution.

Once market allocation is complete further promotion targeting at the store level could be carried out based on a set of rules defined for field sales. These rules would take into account final gap goals and the maximum coupon value available.

Listed below are some factors which brand might want to consider when allocating promotion dollars. Note that consideration of these factors is dependent on data availability which has not been addressed yet.

- Current Price Position (Basic vs Lowest)
- Brand Share Development
- Potential Volume Lift
- Final Gap
- Final Absolute Price (\leq 99 cents)
- Brand Distribution
- Maximum Coupon Value
- Competitive Brands Undercut
- Concentration of Targeted Stores
- Chain versus Independent Emphasis
- Carton versus Pack Emphasis
- Trade Class Emphasis
- County type Emphasis
- Cambridge Development

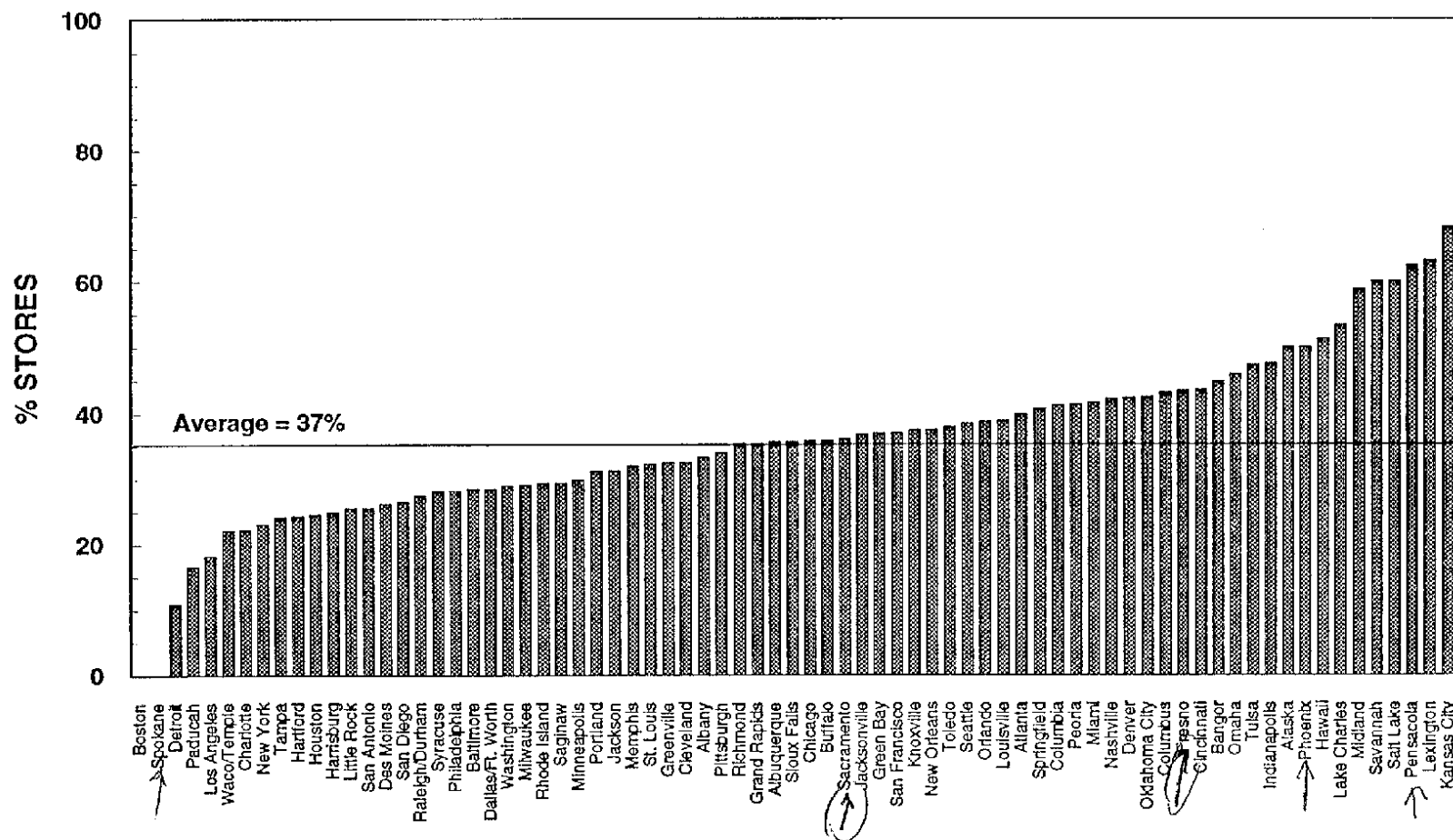
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Attachment 2
FIELD SALES PRICE DATA: 4-WEEK CYCLE ENDING 9-24-93

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BASIC vs. LOWEST BRAND % STORES NON-COMPETITIVELY* PRICED NET PACK PRICE



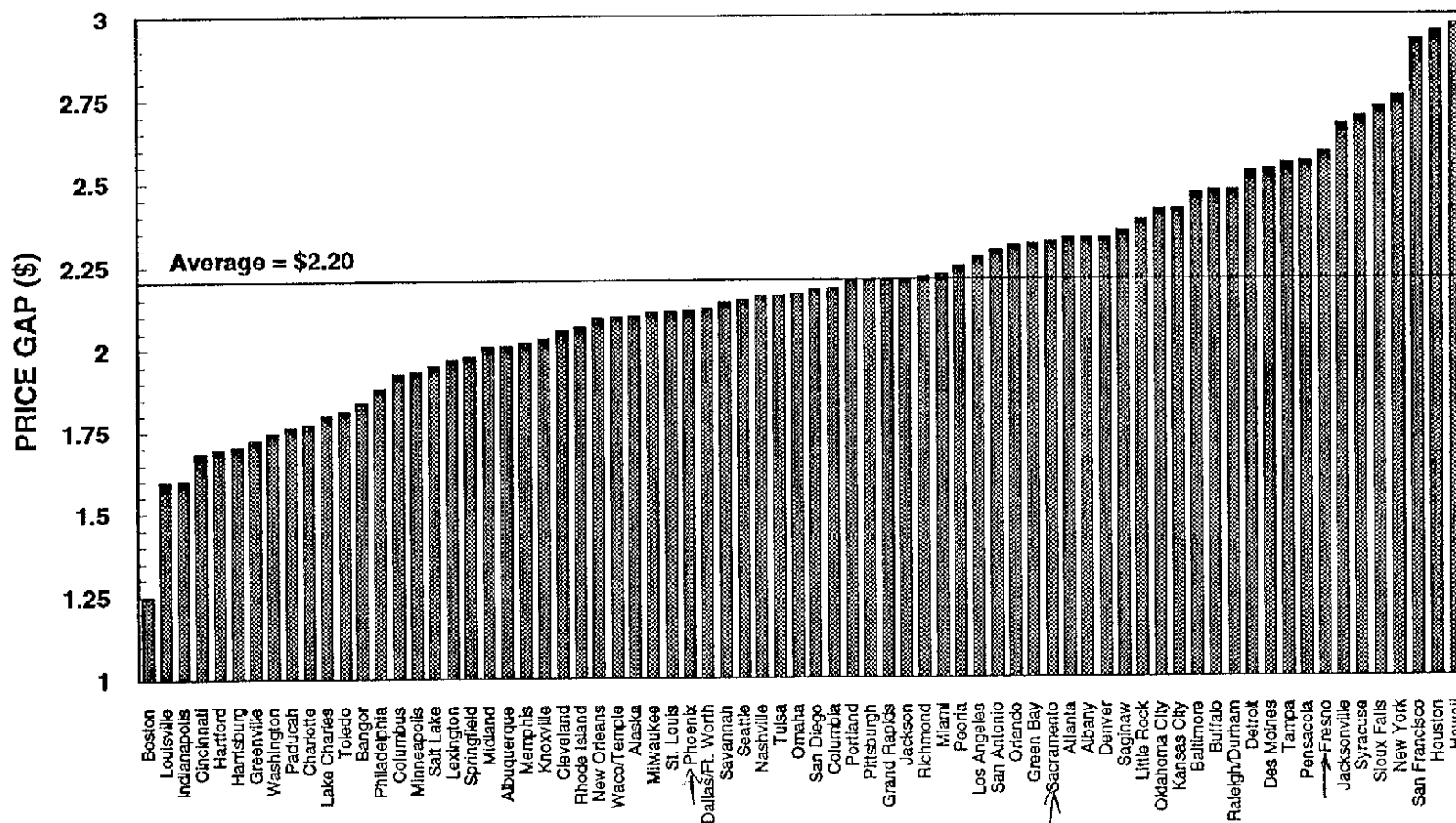
*Price Gap between Basic and lowest priced brand in the store is greater than \$0.10.

ATTACHMENT 2

Attachment 3

FIELD SALES PRICE DATA: 4-WEEK CYCLE ENDING 9-24-93

BASIC vs. LOWEST BRAND **AVERAGE PRICE GAP IN NON-COMPETITIVE* STORES** **NET CARTON PRICE**

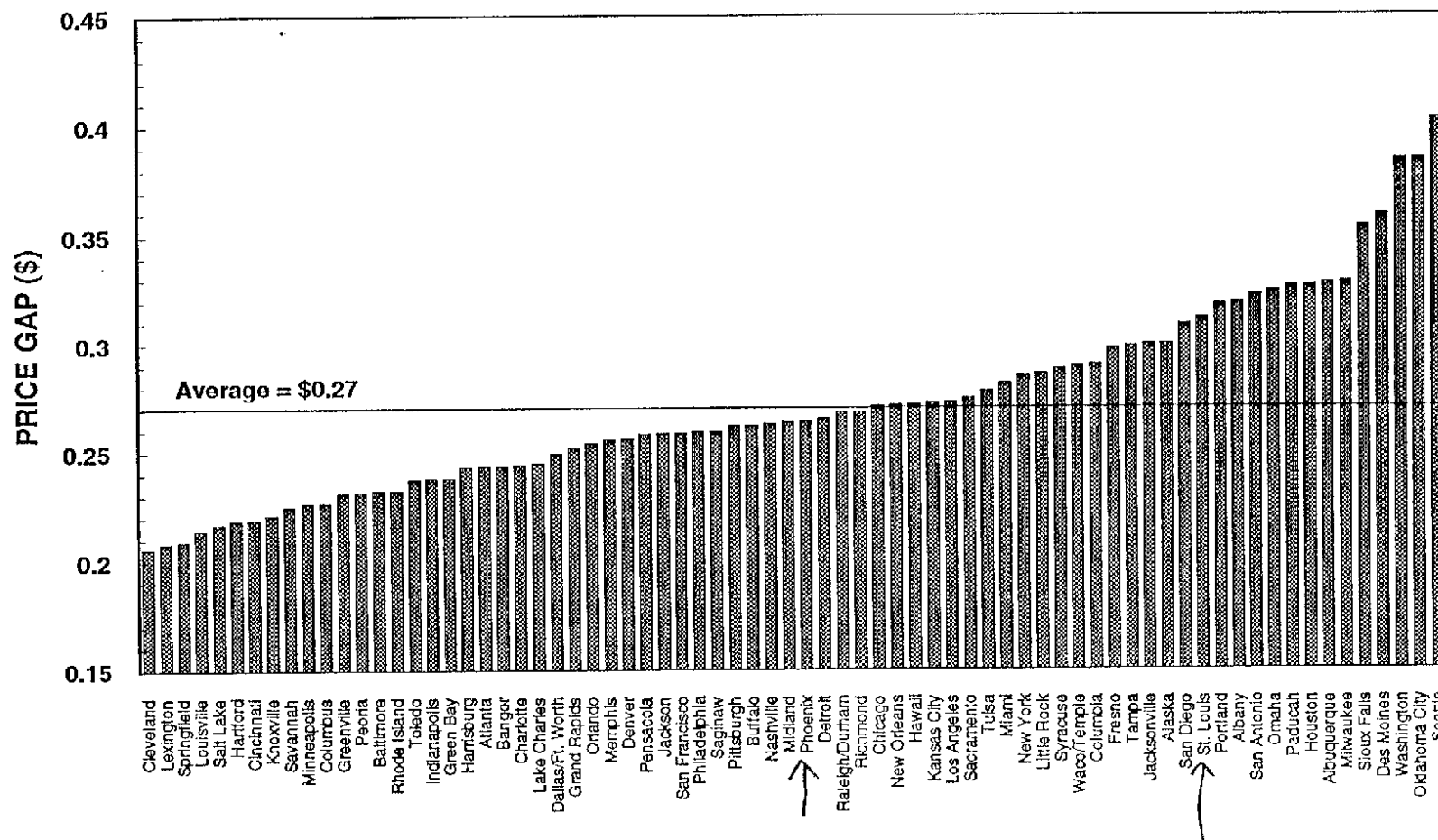


*Price Gap between Basic and lowest priced brand in the store is greater than \$1.00.

Attachment 4

FIELD SALES PRICE DATA: 4-WEEK CYCLE ENDING 9-24-93

BASIC vs. LOWEST BRAND **AVERAGE PRICE GAP IN NON-COMPETITIVE* STORES** **NET PACK PRICE**



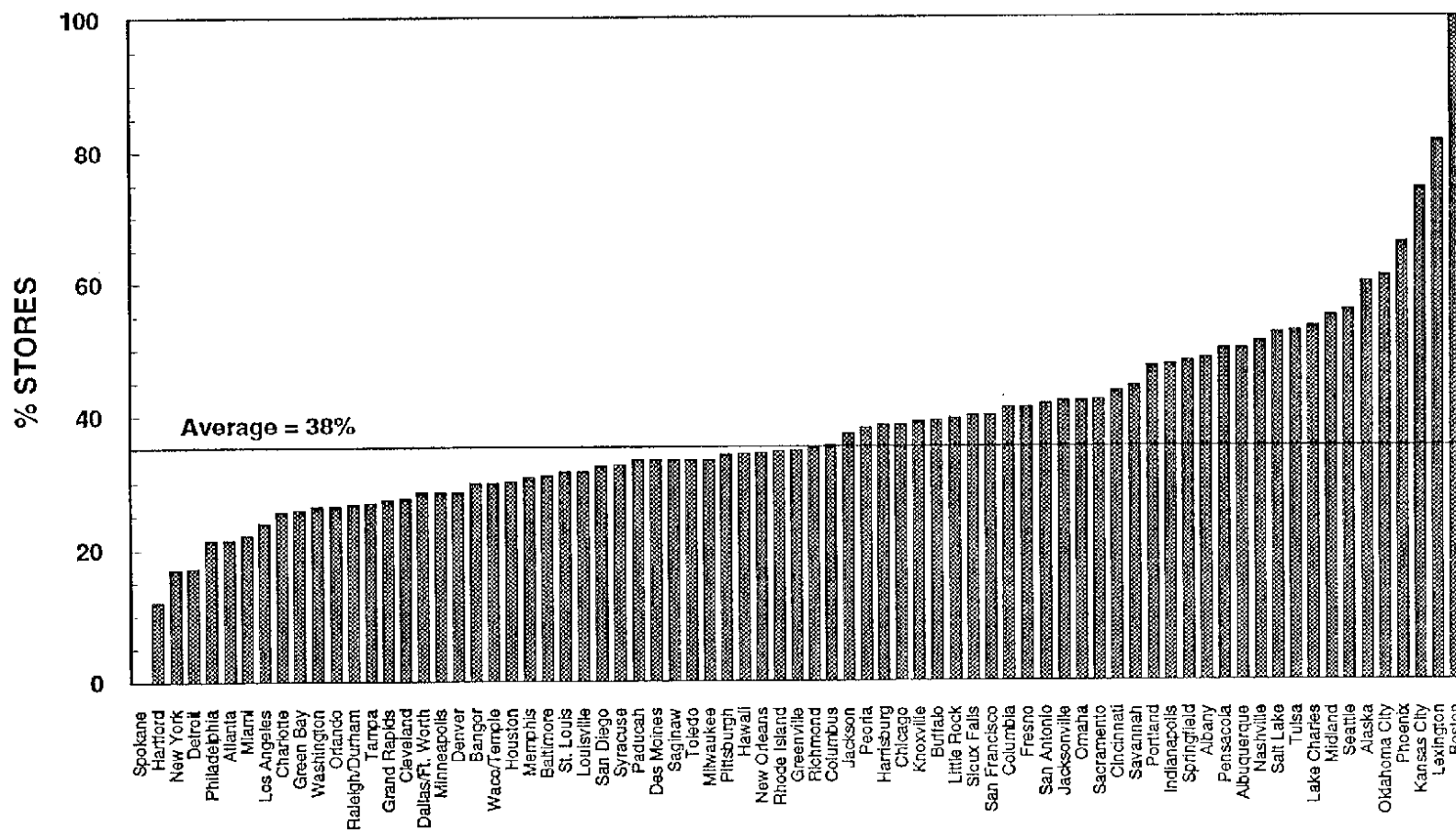
*Price Gap between Basic and lowest priced brand in the store is greater than \$0.10.

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Attachment 1

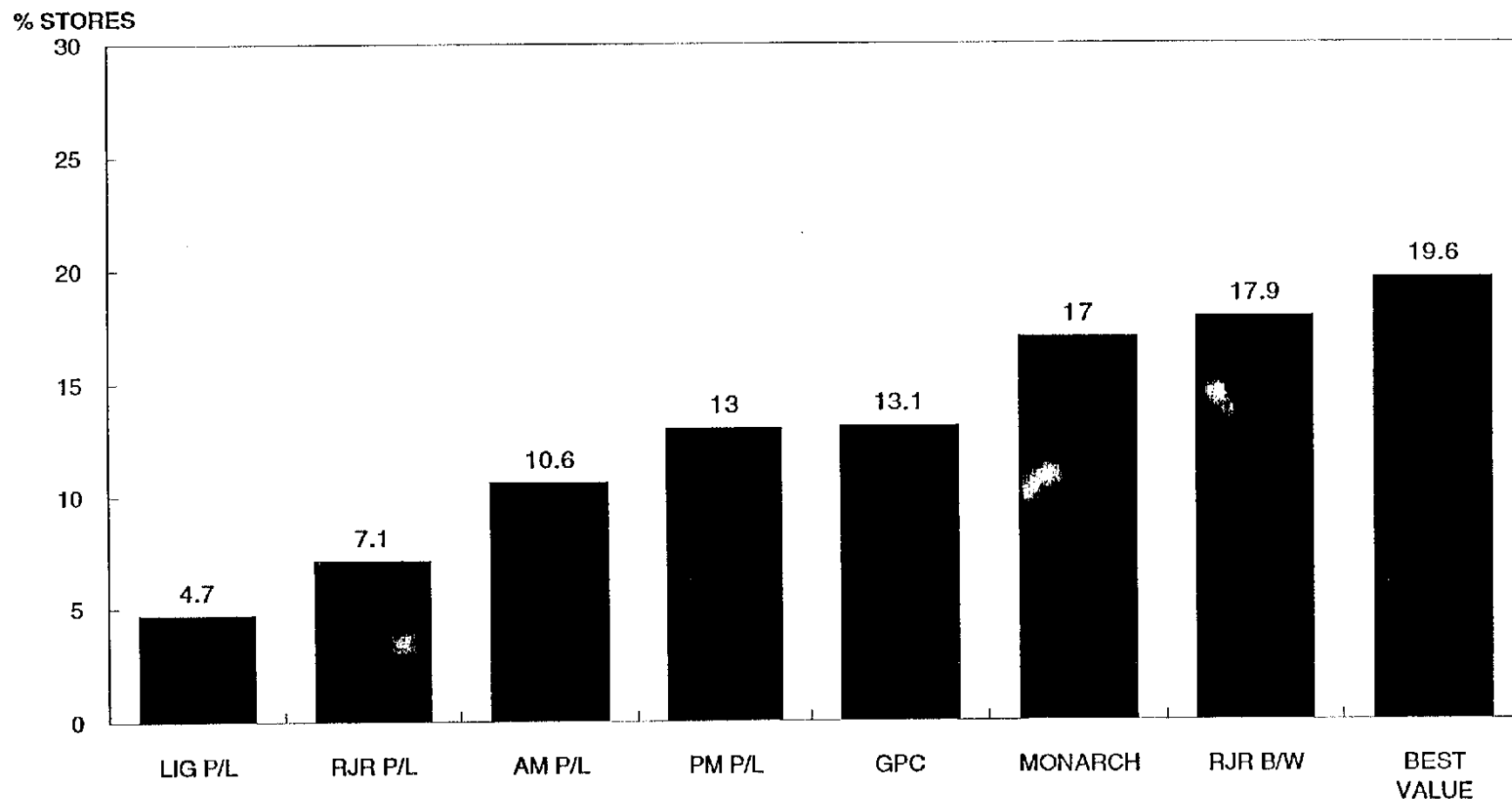
FIELD SALES PRICE DATA: 4-WEEK CYCLE ENDING 9-24-93

BASIC vs. LOWEST BRAND **% STORES NON-COMPETITIVELY* PRICED** **NET CARTON PRICE**



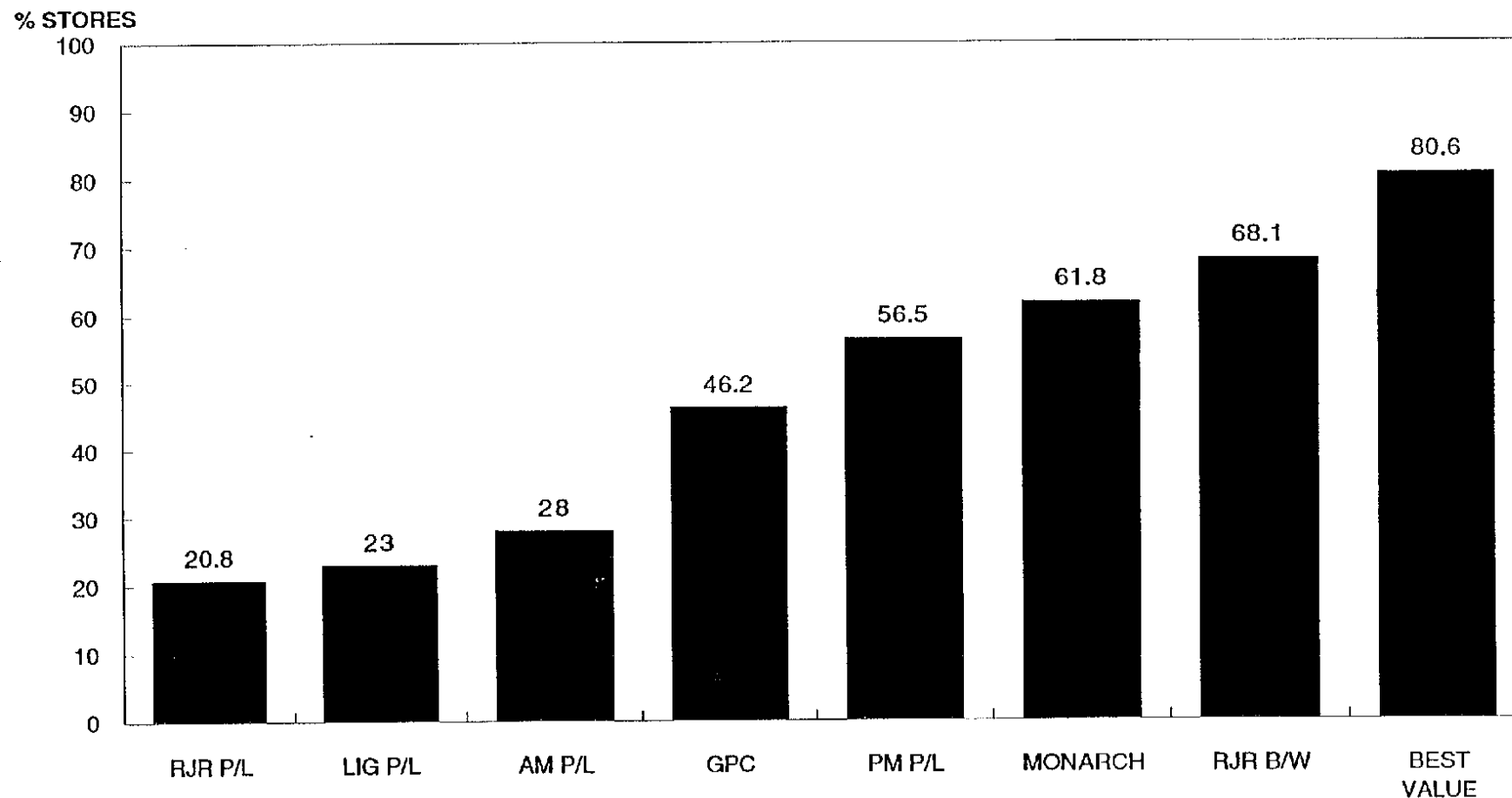
*Price Gap between Basic and lowest priced brand in the store is greater than \$1.00.

IMPACT OF BASIC REDUCTION-BRAND COMPARISON*
% Of Total Brand Distribution Where Basic Undercuts The
Other Brand
NET PACK PRICE-ALL OUTLETS



*Impact in stores where Basic reduces price in order to reach a level no higher than 10 cents greater than the lowest brand.

IMPACT OF BASIC REDUCTION-BRAND COMPARISON*
% Of Stores Selling Basic and Other Brand Where Basic
Undercuts The Other Brand
NET PACK PRICE-ALL OUTLETS

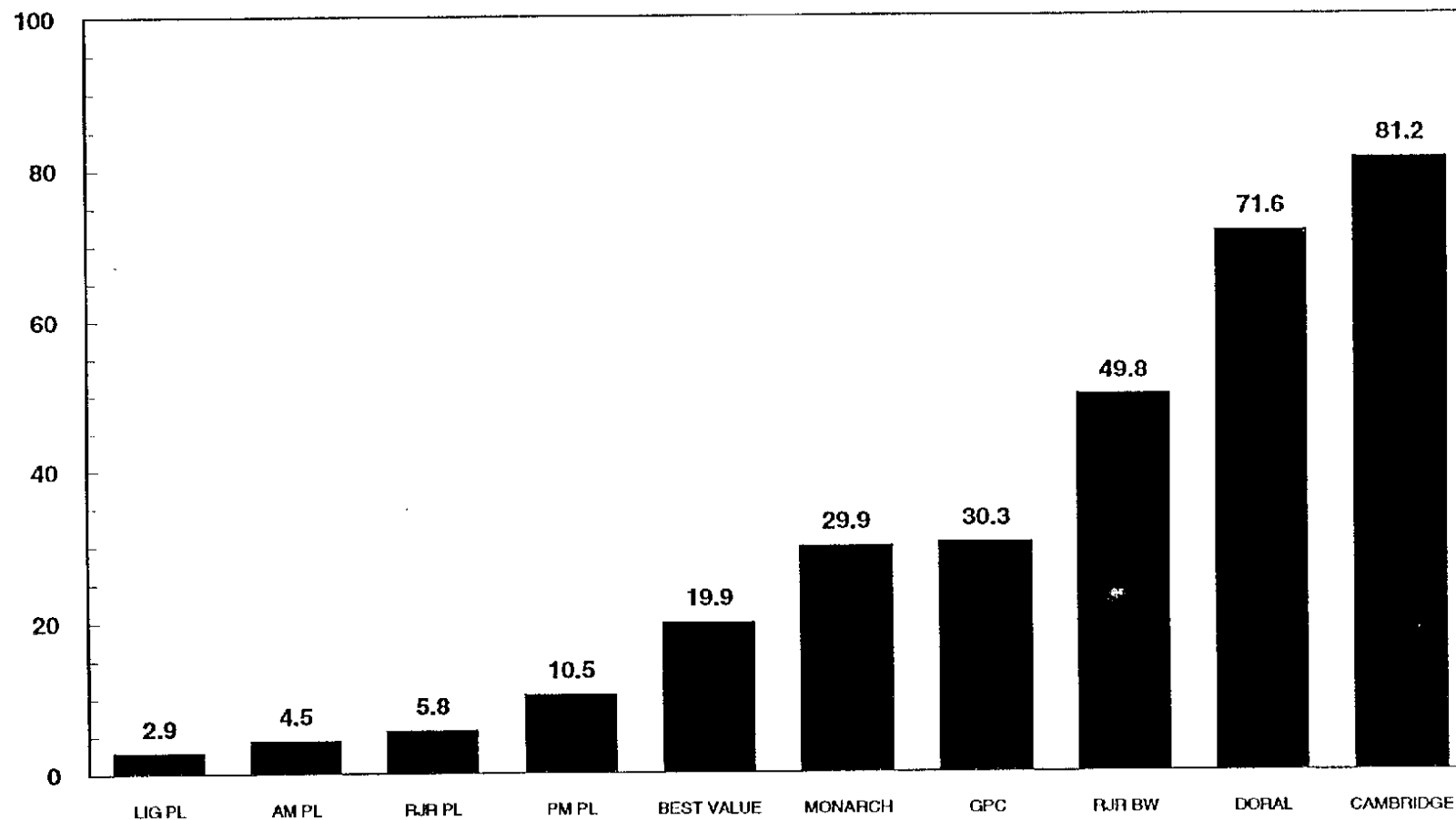


*Impact in stores where Basic reduces price in order to reach a level no higher than 10 cents greater than the lowest brand.

FIELD SALES PRICE DATA: 4-WEEK CYCLE ENDING 9-24-93

BASIC PRICE REDUCTION STORES *
% Of These Stores Where Brand Is Undercut By Basic
Net Pack Price - Total U.S.

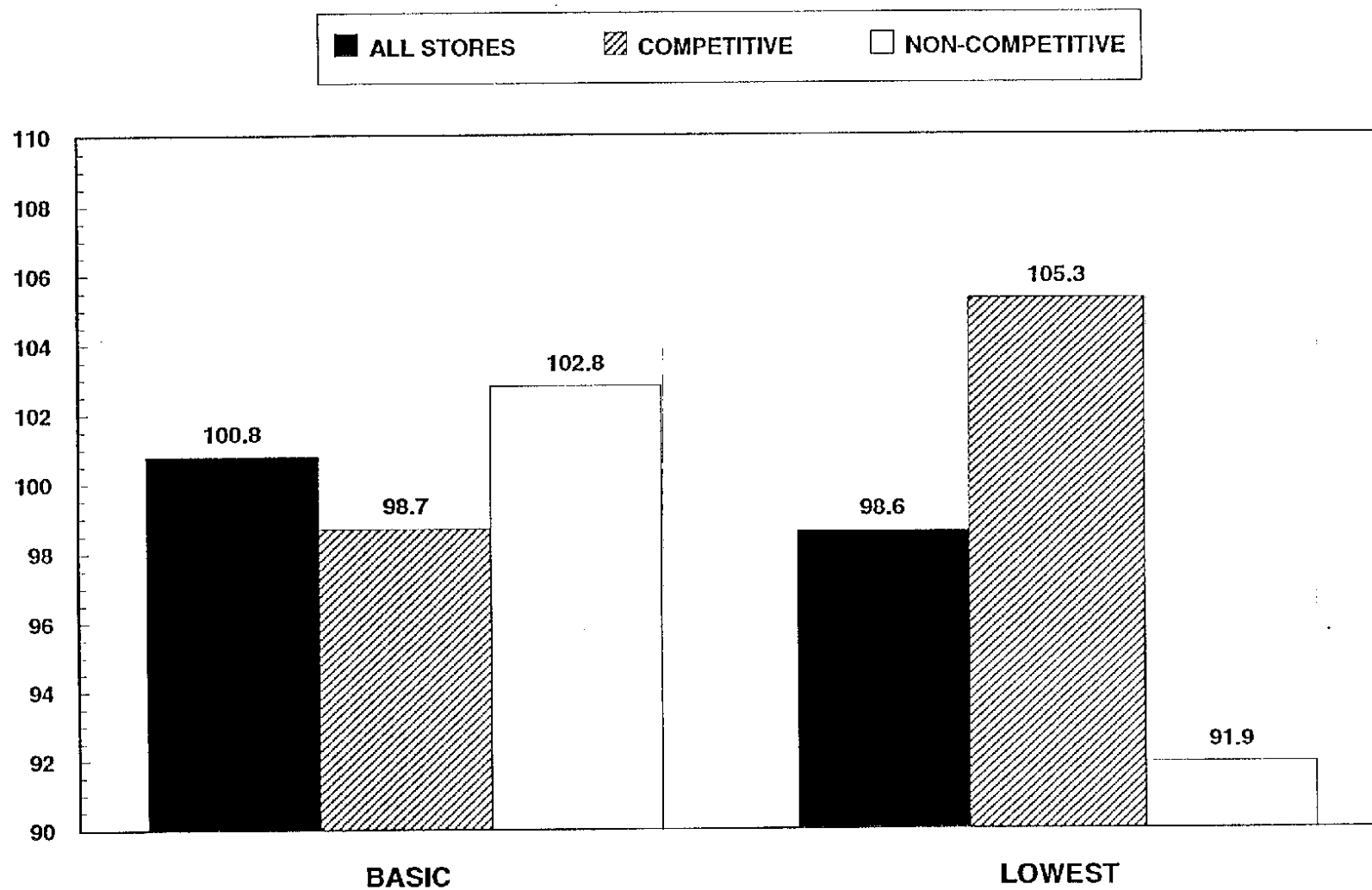
% STORES



*Stores where Basic reduces price in order to reach a level no higher than 10 cents greater than the lowest brand.

Attachment 6

The lowest brand determines Basic's competitiveness 70% of the time.

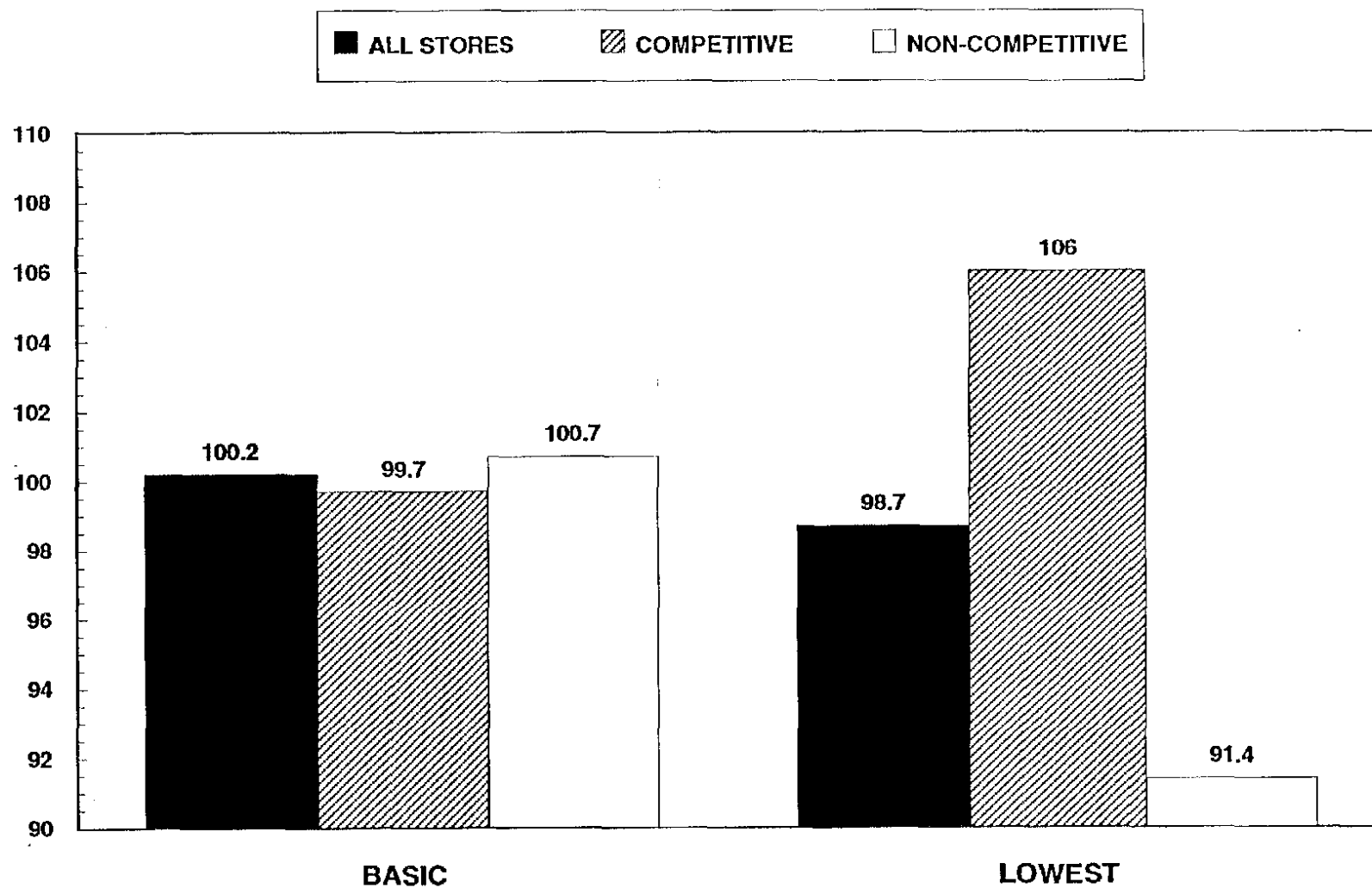
PACK PRICE INDICES

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Attachment 5

The lowest brand determines Basic's competitiveness 73% of the time.

CARTON PRICE INDICES



ATTACHMENT 5